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No. 77-346

In the Supreme Court of the United States

OCTOBER TERM, 1977

HARMONT PLAZA, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

DANIEL M. FRIEDMAN,
Acting Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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The sole question raised by the petitioner in this federal income tax case is whether petitioner, an accrual basis taxpayer, can exclude from its 1970 and 1971 taxable income, rentals to which it had a fixed contractual right of payment and with respect to which there was no doubt as to collectibility.

The pertinent facts are as follows: On June 1, 1955, petitioner leased property it owned in Youngstown, Ohio, to Sears, Roebuck & Company for a 40-year term (Pet. App. B, pp. A-5 to A-8). In 1968, the Cafaros, who owned 90 percent of petitioner's stock, entered into an agreement with Edward J. DeBartolo and the DeBartolo Coporation to build an enclosed shopping mall on property owned by the Cafaros and the DeBartolo Corporation in Boardman, Ohio. The two groups formed a new corporation,

Southern Park, Inc., whose stock was owned by the Cafaros (35 percent) and the DeBartolo Corporation (65 percent). In order to induce Sears to relocate from Youngstown to Boardman, DeBartolo and Southern Park agreed to assume Sears' obligations under its Youngstown lease (Pet. App. B, pp. A-8 to A-10, A-11 to A-17).

In a supplemental agreement, petitioner, DeBartolo, and the DeBartolo Corporation further stipulated that Southern Park would indemnify petitioner for any rental losses which might occur from Sears' departure from the Youngstown property. However, petitioner did not release Sears from its rental obligation under the lease. Under the supplemental agreement, petitioner would look first to Southern Park as the primary indemnitor of any rental losses, and then to Sears if Southern Park failed to satisfy its indemnification obligation[1] (Pet. App. B, p. A-28). The indemnification agreement further provided that Southern Park would allocate its cash flow to certain other of its obligations prior to paying any indemnity rentals to petitioner (Pet. App. A-16).

After October 13, 1969, Sears vacated the premises in Youngstown and made no further rental payments under the Sears lease. Petitioner leased the premises to another tenant. The amount of rental loss incurred by petitioner for its taxable years ended November 30, 1970, and November 30, 1971, was $138,729 and $354, respectively. Neither Southern Park nor Sears has yet paid petitioner for this rental loss as required by the agreement. For its taxable years 1970 and 1971, petitioner accrued as income only the rentals it actually received in 1970 and 1971 and not the rentals due to be paid under the indemnification agreement (Pet. App. B, pp. A-22 to A-23).

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[1]Although petitioner now argues to the contrary (Pet. 3), it conceded in the Tax Court that the supplemental agreement did not release Sears from its rental obligation (Pet. App. B, p. A-30).

On audit, the Commissioner of Internal Revenue determined that petitioner was required to include the amounts due under the indemnification agreement. The Tax Court upheld the Commissioner's position that as an accrual basis taxpayer petitioner was required to include the amounts due under the indemnification agreement because, it had a fixed right to those payments and there was no doubt as to their collectibility (Pet. App. B, pp. A-3 to A-33). The court of appeals affirmed by order (Pet. App. A, pp. A-1 to A-2).

The decision below correctly held that petitioner was required to include the amounts due under the indemnification agreement.[2] It is well settled that when a taxpayer reports his income on the accrual basis, amounts must be included in taxable income when the taxpayer has a fixed right to receive such income, even though actual payment may occur later. See, *e.g.*, *Spring City Co.* v. *Commissioner*, 292 U.S. 182; *Commissioner* v. *Hansen*, 360 U.S. 446.

Here, petitioner had a fixed right to receive the rentals due under the Sears lease from Southern Park and alternatively from Sears itself, since Sears had a

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[2]Petitioner has abandoned the contention that there existed a reasonable doubt of collectibility of the rentals in 1970 and 1971, which justified its decision not to accrue the rentals in those years. See *Georgia School-Book Depository, Inc.* v. *Commissioner*, 1 T.C. 463, 469. The courts below properly concluded that there was no evidence that petitioner could not ultimately expect payment of the loss rentals from Southern Park in 1970 and 1971 (Pet. App. B, pp. A-31 to A-32). Moreover, petitioner conceded the financial ability of Sears to make these rental payments, if Southern Park failed to indemnify petitioner (Tr. 66, 72).

continuing liability to pay the rent due under its lease (Pet. App. B, p. A-30). The indemnification agreement provided that Southern Park would be the primary obligor for the rentals and Sears would be the secondary obligor (Pet. App. B, pp. A-8 to A-10, A-11 to A-17). Thus, the fact that Southern Park did not have a cash flow sufficient to trigger its indemnification obligation did not excuse petitioner's failure to accrue and report the rentals. As the Tax Court pointed out (Pet. App. A-30), petitioner accepted Southern Park as "the primary but not sole obligor" and conceded that Sears was secondarily liable in the event Southern Park did not meet its indemnity obligation. Under accrual tax principles, petitioner had a fixed right to receive the indemnity rentals from two solvent indemnitors. The fact that it did not physically receive them does not postpone their accrual and inclusion in income.

Petitioner therefore errs in arguing (Pet. 5-7) that the indemnification agreement qualified its right to receive the rentals in 1970 and 1971, by making the right to receive the rentals contingent and unaccruable as income in those years. See *Lucas* v. *North Texas Co.*, 281 U.S. 11. As the Tax Court correctly pointed out (Pet. App. B, p. A-31), the indemnification agreement did not affect petitioner's "fixed right to receive" the rentals. Its failure to exercise that right does not postpone the taxation of the amounts due under the agreement. There is accordingly no basis for its exclusion of the rental indemnification from its taxable income for 1970 and 1971. *Commissioner* v. *Hansen, supra*, 360 U.S. at 464. Compare *Georgia School-Book Depository, Inc.* v. *Commissioner*, 1 T.C. 463, with *Guarantee Title and Trust Co.* v. *Commissioner*, 313 F. 2d 225 (C.A. 6).

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DANIEL M. FRIEDMAN,
*Acting Solicitor General.**

NOVEMBER 1977.

*The Solicitor General is disqualified in this case.

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